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Editorial

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The JOURNAL of ACCOUNTANCY

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A. P. RICHARDSON, *Editor*

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EDITORIAL

Order to Come Out of Chaos

It is trite to say that the present is the most important epoch in the history of accountancy; and yet the truth of that statement does not lose any of its force by frequent repetition. Every day brings some new development which may have permanent effect upon the future of the profession. Much of the ultimate significance of what is being done or attempted can not be foreseen, yet everyone is conscious that out of the current whirl of experimentation will emerge an accountancy different in many ways from the original form. Individual accountants may approve or disapprove the many theories which are being enunciated, but there can be no difference of opinion as to the tremendous importance of the effects which must be felt by accountants throughout the country—and to some extent by accountants throughout the world, because we have passed beyond the boundaries of national isolation, whether we like it or not. Fortunately, many members of the profession are keenly interested in the part which the American Institute of Accountants is playing in an effort to guide business and finance into a more desirable state than they have ever known in the past. Much of the new adventure will fail, much will be of little final value, but, nevertheless, much will remain which will make for better and safer conduct of American business. During the early days of 1933 and 1934 the government and its vast multiplicity of commissions, boards, agencies and the like were striving after something which they had not clearly defined in their own minds.

The great point was that there should be a change, and, consequently, attempts were made to regulate and to regiment with a thoroughness and a lack of knowledge which were full of jeopardy for everyone in the whole country. Gradually, however, the wilder ideas were discarded one by one, and, before the revolution is over, we shall doubtless find that the most serious dangers in the frenzy of reformation will have been overcome and wisdom will prevail.

Listening to Reason One of the most vivid illustrations of the bringing in of wiser counsels is afforded by the securities and exchange commission. In *THE JOURNAL OF ACCOUNTANCY* for February, 1935, attention was directed to the sympathetic and intelligent efforts of the commission to carry on its functions with the least possible obstruction to business. It seems safe to say that, of all the commissions appointed under the present administration, none has shown a more receptive attitude toward competent advice and none has met greater cordiality of coöperation. Indeed, while there must be a measure of approval for a few of the acts of other commissions—the perfect commissioner is yet to be born—it is undoubtedly true that if all the commissions had been imbued with a reasonableness similar to that displayed by the securities and exchange commission most of the difficulties of the past two years would have been avoided. On one vitally important point the commission did not accept the suggestions of accountants. This was the amount of disclosure required by the securities and exchange commission in form 10, as it is commonly called. This form is the one which calls for financial statements revealing certain essential facts. Here it is provided that the profit-and-loss statement shall disclose the amount of gross sales, cost of sales and gross profits. At first glance this seems as indefensible and dangerous as the absolutely unwarranted provision under the income-tax law of 1934, that all income-tax returns shall be available for inspection, under certain regulations which do not constitute a barrier to any inquisitive soul who will take the trouble to make inquiry. It is directly contrary to the American ideal to have one's financial status a matter of public record, and we must believe some wiser and less obedient congress will soon abolish, we hope forever, the principle of indecent exposure. Following the public disgust with the publicity provisions of the

income-tax law, it was not astonishing that there should be public dread of a similar inquisitiveness on the part of the securities and exchange commission. In general, however, the commission was receptive and did not arbitrarily cast aside the opinions of informed advisors.

**For Protection of
Trade Secrets**

A committee of the American Institute of Accountants, which has been in frequent conference with the securities and exchange commission, prepared recommendations for the administration of the law which, it was felt, would do much to mitigate the dangers inherent in literal interpretation. Everyone who knows anything of the conduct of business understands the argument that trade secrets must be trade secrets if trade is to survive. If we were to have a full disclosure of every item of the accounts of a corporation engaged in competitive endeavor there soon would be no competition. Everyone would be placed upon a common level and we should have a flattening of business which would prevent success in any department. In the memorandum submitted by the Institute's committee the two most serious objections to the disclosure of confidential information were, first, that it would be detrimental to the interest of investors and therefore contrary to the purpose of the law; and, second, that the information itself might be misleading. These objections were supported by illustrations of typical cases in which disclosure of sales and gross profits might be detrimental to the interest of investors and another series of illustrations of how such information might be actually misleading. We take the liberty of quoting three of these examples:

"(1) While such information might seem to indicate a trend, it could be seriously confused by individual sales policies, selling prices, seasonal business and other factors. It would be impossible to convey to stockholders data on all these points.

"(2) Some products are seasonal; others are sold for immediate consumption; and still others are sold for new plant and equipment and would not represent repeat business. The bare facts as to sales would in many cases fail to indicate correct trends.

"(3) In certain sections of various industries, such as sugar or metals, companies receive their profits for their services in refining or processing, and the price of the raw materials is of comparatively little importance; in fact in many cases the companies may undertake a large volume of business under what is called a 'tolling' arrangement, i. e., to process the raw materials

owned by others and to charge only for services in processing. The company might have done more processing business in one year than another year when there was comparatively little of this 'tolling'; although in the latter year the sales reported might be substantially higher, due to the inclusion therein of a greater amount of raw material. In other words, larger sales would be shown in the year in which less business was actually transacted."

**Misleading Statements
of Fact**

The committee might have gone even further and have referred to the absolute injustice of conclusions which might be drawn from the figures for any one year. If a corporation, let us say, were engaged in the shipbuilding industry, it might have the rare good fortune to make a contract for the construction of mail steamers and derive, because of peculiar conditions or some accident of overestimating cost, a profit which to the casual inquisitor would look fabulously large—as indeed it might be. The public, with the full record of costs and contract prices before it, might be pardoned for coming to the conclusion that the company was making more profit than could be considered compatible with the public interest and with sound business principles. The same company in a dozen subsequent contracts might lose more than it had made in the one fortunate case. All company contracts are made in the hope that the general average will produce a profit, and the history of most industries shows that over a period of years the profits are seldom excessive. Yet if the one profitable year of our hypothetical company were fully reported to the public the reputation of that company would be affected for years to come. The subsequent losses would never overtake in public appetite the apparently outrageous profits of one unusual contract.

**General and Adminis-
trative Expenses**

The Institute's committee also raised the question whether in all cases listed companies should or should not be required to show the amount of selling, general and administrative expenses. Here the committee suggested three ways in which companies could be protected from the necessity of full disclosure and at the same time give to the public all the information which was sought in what the committee believes to be the spirit of the law. The committee suggested that, when the commission felt disclosure was required, companies should be permitted

(a) to show sales and to combine cost of goods sold with selling, administrative and general expenses; (b) to show sales first as a memorandum only and then to begin the statement with the net operating profit from the normal operation of the business; or (c) to show as the first item the gross profit and to deduct from that amount the selling, administrative and general expenses. On this point it is hoped that the commission will issue liberal regulations. In the meantime it is consoling to recall that the law includes a provision that information which would imperil the welfare of a company may be submitted to the commission on the understanding that it shall be kept in confidential files and shall not become public property.

No Change in
Certificate

The *Bulletin* of the American Institute of Accountants, published February 15th, contained an informative review of the progress of negotiations between the securities and exchange commission and the Institute's committee. Here the coöperative spirit of the commission is increasingly revealed. The *Bulletin* review refers to statements recently made by three members of the commission, James M. Landis, George C. Mathews and Robert E. Healy. All these commissioners emphasized their desire to permit the utmost flexibility in the presentation of the required audit report. Many inquiries have been received as to the forms of certificates required for annual reports to stockholders, and the Institute's committee has sent out to the membership a letter advising that no changes in the form of certificate seem to be necessitated by the act or regulations, and that the form approved by the Institute and endorsed by the committee on stock list of the New York stock exchange is appropriate for use in reports to stockholders.

Disclaimers Generally
Undesirable

Another question which will undoubtedly arise in the minds of accountants who are called upon to prepare statements required by the securities and exchange act is whether or not accountants should disclaim any responsibility for matters which do not come strictly within the scope of their survey. For example, must the accountant definitely disclaim responsibility for knowledge of the physical condition of properties? Must he decline to assume liability for quality and

quantity of inventories? Questions of this kind and questions of validity of titles will occur, and the accountant will be confronted with a serious problem of the wisdom or unwisdom of clearly limiting the appearance of responsibility. We have always felt that qualifications in the form of disclaimers may have most unexpected effects. If a man announce that he does not beat his second wife, does he, by inference, admit that he did beat the first wife? On the other hand, if he maintain a silence upon the subject of marital infelicity it is probably safe to assume that he beat neither wife. So an accountant who disclaims responsibility for validity of title may, by inference, appear to admit responsibility for some other similar item in the accounts. Of course, there must be qualifications in many certificates; but we are speaking now of that form of qualification which is known as a disclaimer. It is easy to talk too much, and the man who is busy disclaiming a few things may find himself saddled with liabilities which otherwise would never have been attributed to him. Furthermore, technical disclaimers are apt to catch the eye of the reader before anything else, and thus to distract his attention from the really important matters of the reports. It may be that subsequent laws and regulations may render disclaimer of certain specific matters imperative, but it seems to be the safe rule to avoid mention of things which obviously or by custom fall without the range of the accountant's responsibility.

**Valuation of
Inventories**

One of the important questions which confronts every concern engaged in selling merchandise is the valuation of inventories when there is a more or less continuous flow of goods or commodities both inward and outward. The matter is particularly important in the case of oil companies, and it is interesting therefore to review the action of the board of directors of the American Petroleum Institute at a recent meeting in Dallas. The Petroleum Institute's committee on uniform methods in oil accounting had recommended the principle of "last in, first out" in valuation of petroleum inventories. We quote the following excerpts from the report:

"Current costs of crude oil and products should be charged against current sales as long as inventory quantities remain ap-

proximately unchanged, or sales are about equivalent to new acquisitions (production and purchases).

"In the costing of crude oil stock (inventory), current production and current purchases should be the first applied to current cost of sales and current operations. . . .

"In the costing of product inventories, current purchases and current production should be the first applied to current cost of sales and current operations. . . .

"In starting the 'last in, first out' inventory plan, the prices should be set at a conservative or reasonable figure. In the future, inventory prices should not be reduced to market prices, when lower than the regular inventory value. Where the market value of the inventory is less than that carried in the balance-sheet, such condition should be shown in parentheses or as a footnote in such manner that the approximate difference can be ascertained, either in dollars or percentage."

There will be differences of opinion as to the accuracy of the method of valuing inventory which is recommended by the Petroleum Institute, and in recognition of this fact it has been arranged that deliberations shall take place between the accounting committee of the Petroleum Institute and the American Institute of Accountants' special committee on inventories. These deliberations should determine whether the principle of "last in, first out" may be considered as acceptable and in consonance with sound accounting or, if there be a difference of opinion between the two committees, what alteration in the method of application of some such principle may be required to make it acceptable. There has been something resembling a tradition in favor of "first in, first out" for ordinary merchandise inventory valuation, but it may be that there is something inherent in the inventory of commodities such as oil which will justify the principle which the Petroleum Institute now advocates. At any rate the question is of more than academic importance and the two committees should be productive of something almost authoritative.

**Accounts of Code
Authorities**

Many accountants have been commenting upon the instructions to auditors of books and accounts of code authorities recently promulgated by the national industrial recovery board. In general, the instructions are regarded as satisfactory and not in conflict with the principles of sound accounting, but there is a good deal of dissatisfaction with the

concluding section of the instructions which calls for an affidavit by the auditor. The form of affidavit reads as follows:

"I solemnly swear that the audit of the books and accounts of code authority reported on herein was made by me or by my employees under my direction in conformity, as nearly as possible in the circumstances, with the *Instructions to Auditors of Books and Accounts of Code Authorities*, and that I am qualified to audit the said code authority as a 'competent, independent auditor' as defined by the national recovery administration in its administrative order No. X-119, dated December 5, 1934.

"Sworn to before me this day of in the year 19...."

While most auditors will cheerfully admit that they are "competent", it is not customary to make an affidavit to that effect, and we doubt if many would consent to make an affidavit in such form. It savors too much of routine and too little of professional responsibility. It sounds very much as though it were founded upon a form of affidavit relative to the constituents of some article of manufacture. (Parenthetically, we may perhaps be permitted to inquire, why by tradition the word "solemnly" precedes the word "swear." Does one often gaily swear?) One of the great difficulties innate in all attempts to regiment business is the tendency to do by rule of thumb things which should be done by rule of brain. An auditor is not a machine—at least he should not be—and any attempt to dictate the nature of his certificate is abhorrent. It is probably well enough to lay down a scheme of instructions relative to the scope of audit, but restriction should not extend to the auditor. As an illustration of the sentiment of accountants on this subject, we quote the following certificate which was written by one of the well-known firms:

"We have made an examination of the accounts and records of the for the year ended December 31, 1934. This examination has conformed in general with the *Instructions to Auditors of Books and Accounts of Code Authorities*. No partner or employee of the firm is connected with the code authority; our only relation is that of an independent auditor. Based on our examination and information furnished to us, in our opinion the accompanying statements, subject to the comments in this report, correctly set forth the financial condition of the at December 31, 1934, and the results of its operations for the year ended at that date."

This certificate differs radically from the form of affidavit prescribed by the national industrial recovery board. It reserves

to the accountant the status of a professional man, and it tells the truth so that any one can understand it. No doubt the national industrial recovery board will be perfectly willing to accept a certificate in the form just quoted and will not attempt to insist upon a mere inflexible affidavit.

**A Perennial
Question**

From time to time it has been the custom in these pages to attempt to answer an ever-recurrent question which really has no answer. Here is an illustration of its latest expression:

"I am taking the liberty of writing to you to ask your advice in regard to a personal problem which is worrying me.

"I am an accountant, age 45, and have had many years' experience in manufacturing industries—for the past five years have specialized in cost-accounting in private practice. Largely due to the depression, I have been out of employment and at my age find it rather difficult to obtain a position.

"Do you think industrial concerns are giving preference to younger men? Has a man at my age a chance of obtaining employment? If there are yet opportunities in industry for the middle-age man, what in your opinion would be the best field to engage in, general accounting or cost-accounting?

"I have considered taking up the public practice of accounting, giving part time bookkeeping service for small concerns, preparing financial and profit-and-loss statements, etc. Would you please advise me as to what would be a fair and proper fee to charge for this service, on an hourly, weekly or monthly basis?

"Any advice or suggestions you can give me regarding my future work in accounting would be greatly appreciated."

During the life of *THE JOURNAL OF ACCOUNTANCY* perhaps a thousand letters have been received making the same inquiry: What is a man of middle age or old age to do? Is there room for him anywhere? Is he not better qualified than some newcomer could possibly be to carry on the work of an accountant's office? Does not justice require that he be given an opportunity to employ his talents and to earn for himself and his family a livelihood?

**Fact and Theory
Discordant**

Of course, the answer to the last question, if carelessly given, is always Yes. He should have a chance, and no doubt he will do much better work than many who are younger than he—but that is no answer at all. There are scores of men

who carry their natural adaptability with them into middle and later life, but it is difficult to convince a prospective employer that he can make a man of advanced years conform to the practices of an office as readily as a man who has not become set in his ways. Then, again, there is always the question of physical strength—and the work of an accountant's office is onerous, trying and tiring. The young man can be sent anywhere and be reasonably content, but the older man is apt to become fretful and unhappy if hardship has to be encountered. The great determining factor is one that can not be considered at all in correspondence: that is the question of personality. If this whole problem be considered on the basis of sentiment, there is, of course, no justification for preferring young men to men of advanced years; but one can not conduct a business or a profession or any other activity of life, outside of pure philanthropy, without giving some consideration to pragmatic questions. It is all wrong in principle that a man of forty-five should be less desirable than a man of thirty; but one is a fool to attempt to shut his eyes to the facts, however unfair they may appear. We have no sympathy at all with the organization which fails to recognize long service and rudely dispenses with old and well paid men in order to take in younger and cheaper men. That seems entirely reprehensible; but that is quite different from choosing between two applicants for positions, one a young, healthy, vigorous and somewhat proficient man and the other a man who has passed the prime of life and almost always has the disabilities which age brings in its train. To attempt to answer the specific question in the letter which we have quoted is, as we have said, futile. Whatever answer is given may be altogether erroneous in the particular instance; but, speaking generally, we believe it safe to say that accountancy is not the place to attempt a new adventure in the afternoon of life.